200249013

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

SEP 12 2002

T: EP: RA: T3

Uniform issue list: 72.00-00, 101.00-00, 264.00-00, 401.00-00, 403.00-00, 7702.00-00

Attention:

Legend:

Company A =

Company B =

Company C =

Company D =

Company E =

Company F =

Director J =

State M =

Court N =

Dear

This is in response to your request for a ruling dated May 9, 2001 regarding the taxability of proposed cash distributions on behalf of Company A under the Internal Revenue Code ("Code"). Correspondence dated October 3, 2001, October 31, 2001, February 22, 2002, April 5, 2002, and August 27, 2002, supplemented the request.

Company A was formed as a mutual holding company in connection with a Plan of Reorganization adopted by the Board of Directors of Company D, a stock life insurance company organized under State M law, on *************, ***** (the "Formation Plan"). On **************, ****, the Formation Plan became effective and Company A became the parent of Company B, which, in turn, became the parent of Company D. Company A has no authorized capital stock. Company A currently does not qualify as a "life insurance company" under section 816 of the Code

Company D was originally formed as a stock life insurance company. During the period ******* through *****, Company D completed a process of mutualization. Pursuant to the Formation Plan, in **** Company D converted back to a stock life insurance company in connection with the formation of the mutual holding company structure.

Until the events leading to the Rehabilitation, Company A was a mutual insurance holding company that owned 100% of Company B, which owned 100% of Company D , an operating insurance company that qualified as a "life insurance company" under section 816 of the Code.

Company D offers a full line of insurance products, including ordinary life, universal life, variable universal life, individual annuities, pension trust, salary savings, pensions and reinsurance (collectively referred to herein as "Policies"). Each Policy provides insurance coverage or annuity benefits to the extent, and in the amount, specified in the Policy. Policyholders holding dividend-paying Policies were and continue to be entitled to dividends when and if declared by Company D' s Board of Directors. Aside from the contractual right to receive Policy benefits *(i.e.,* payment under the terms of the Policy) ("Contract Rights"), the holders of Policies ("Policyholders" or "Members") also possessed certain proprietary rights with respect to, and interests in, Company A as a mutual company (hereinafter "Membership Interests"). Company D's Policies include Policies that are held as part of, or in connection with, tax-qualified retirement plans described in section 401(a) (a "Section 401(a) Plan"), section 403(a) (a "Section 403(a) Plan"), section 403(b) (a "Section 403(b) Arrangement") or any individual retirement annuity described in section 408(b) (an "IRA") (collectively, "Tax-Qualified Retirement Contracts").

A series of events caused Company D to face a short-term liquidity problem (the "Liquidity Crisis"). The Liquidity Crisis occurred as a result of Company D's funding agreement business. Company D had sold a number of funding agreements to institutional customers, such as pension, mutual and money market funds, that had seven or thirty-day cash-in options. Company D began issuing funding agreements in **** in connection with its entering into an indemnity reinsurance and marketing arrangement, with Company E, and Company E's subsidiary, Company F.

Pursuant to the reinsurance arrangement, Company D transferred 50% of its funding agreement obligations to Company F, but Company D remained ultimately responsible to satisfy all required payments to the holders of such reinsured funding agreements. Between **** and ****, Company D issued approximately $6.8 billion of funding agreements. One-half of Company D's liability under such agreements, or $3.4 billion, was reinsured with Company F. Company F invested such funds in highly interest-rate-sensitive investments, which were difficult to sell at full value when the funding agreements were cashed in.

In ****, Company F's and Company D's funding agreement business began to falter. In ******** ***** Company D's credit rating was downgraded. Then in May ******, Company E decided to exit the funding agreement business in connection with the downgrading of its credit rating. Company D, effective ***********, ****, recaptured the funding agreement business it had reinsured with Company F. As a result of such recapture and losses announced by Company F pursuant to its funding agreement business, the credit rating was further downgraded. This second downgrade caused many of the funding agreement holders to exercise their seven or thirty-day cash-in options. The money that Company D had set aside to satisfy such funding agreements was not sufficient to satisfy the holders of approximately $4 billion in funding agreements that demanded cash between *****, **** and *****, ****.

Company D immediately tried to sell certain of its assets to satisfy its funding agreement obligations. By ********, ****, Company D knew that it would be unable to sell sufficient assets to satisfy such obligations without incurring losses that could adversely affect its ability to meet its obligations to all of its other Policyholders. As a result of the Liquidity Crisis Company D asked Director J of the State M Department of Insurance to place it under administrative supervision on *********, ****. Company A and Company D then began exploring alternative options under the oversight of the Director J.

After Company D was placed under administrative supervision, Company A, Company D and Director J worked to resolve the Liquidity Crisis without causing harm to the Policyholders. The parties decided that the best strategy was to sell Company B (together with its subsidiaries, including Company D) (the "Sale"). Company A then auctioned off Company B with Company C submitting the winning bid.

On ************, ****, an order was entered for Company A' s Rehabilitation. The Rehabilitation of Company A was separate from Director J's administrative supervision of Company D (which concluded after the Sale closed). The Rehabilitation allowed the Sale to occur before it was possible to determine Company A's liabilities. Under the Rehabilitator's supervision and pursuant to approval of Court N, Company A and Company C closed the Sale on *********, ****. Since such date, Company A has been a stand-alone company under the control of the Rehabilitator and Company D has been a subsidiary of Company C, with no affiliation whatsoever to Company A.

The Rehabilitator intends to liquidate Company A through the cash payment of any surplus that Company A holds as a result of the Sale after deduction of all claims and expenses provided for in the Reorganization Plan (the "Company A Surplus") to the beneficial owners of all Policies in effect as of *********, ****.

The Sale did not affect the terms of any Policy, and all Policies are continuing in force with Company D in accordance with their terms notwithstanding the Sale. In particular, the Sale did not affect the level of premiums, coverage, or benefits payable under any Policies and dividends will continue to be declared in respect of the Policies entitled thereto at the discretion of Company D's Board of Directors. Accordingly, the Sale did not affect the Contract Rights of any Policyholder. However, because Company A has no affiliation with Company D, Company A cannot control whether Company D will change the Policies in the future.

Based on the foregoing the following rulings are requested:

1. The Sale did not have, and the payment of liquidation proceeds attributable to the Membership Interests derived from the Policies pursuant to the Liquidation will not have, any effect on the date that any Policy was issued, purchased, or entered into for any purpose of the Code including sections 72(e)(4), 72(e)(5), 72(e)(10), 72(e)(11), 72(g), 72(s), 72(u), 72(v), 10l(f), 264(a)(3), 264(a)(4), 7702, and 7702A, and will not require retesting or the start of a new test period for any Policy under sections 264(c)(1), 7702(f)(7)(B)-(E), or 7702A(c).

2. Cash payments made to Participants pursuant to the Liquidation will not be treated as distributions from the Tax-Qualified Retirement Contracts that are subject to section 401(k)(2)(B) or section 403(b)(11) in violation of the requirements of such sections.

In this case, the actions were not initiated by the policyholder and do not result in a change of the existing contractual obligations of the underlying insurance policies. All the terms of the policies remain unchanged. Company D will remain liable under those contracts. The policyholders' relationship with Company D remained unchanged. The policyholders' ownership relationship with Company A is independent of their policyholder relationship with Company D.

Accordingly, based solely upon the information submitted and the representations made, it is held, with respect to your first ruling request, that the Sale did not have, and the payment of liquidation proceeds attributable to the Membership Interests derived from the Policies pursuant to the Liquidation will not have, any effect on the date that any Policy was issued, purchased, or entered into for any purpose of the Code including sections 72(e)(4), 72(e)(5), 72(e)(10), 72(e)(11), 72(q), 72(s), 72(u), 72(v), 10l(f), 264(a)(3), 264(a)(4), 7702, and 7702A, and will not require retesting or the start of a new test period for any Policy under sections 264(c)(1), 7702(f)(7)(B)-(E), or 7702A(c).

With respect to your second ruling request, section 72(e) of the Code generally provides that gross income includes any amount received as an annuity under an annuity, endowment, or life insurance contract. Section 72(e)(2) provides that any amount which is received under an annuity, endowment or life insurance contract and is not received as an annuity, (i) if received on or after the annuity starting date, shall be included in gross income, and (ii) if received before the annuity starting date, shall be included in gross income to the extent allocable to income on the contract and shall not be included in gross income to the extent allocable to the investment in the contract.

Section 401(a)(9) of the Code requires, in part, that the entire interest of an employee under a qualified retirement plan be distributed, beginning no later than April 1 of the calendar year following later of the calendar year in which the employee attains age 70 ½ or the calendar year in which the employee retires, over the life or life expectancy of the employee (or over the joint lives or joint life expectancy of the employee and a designated beneficiary).

As a general rule, all interest, dividends, capital growth, stock distributions or any other change in the nature of assets, through reorganization, recapitalization or otherwise, are held as part of the tax-deferred solution, i.e., the TSA, the IRA and the qualified plans, until the assets are distributed. Only upon distribution are such increases in account value taxable to the recipient.

Any membership interests in a mutual insurance company which arise from the purchase of an insurance contract are inextricably tied to the contract from the time of purchase. These membership interests are created by operation of state law solely as a result of the policyholder's acquisition of the underlying contract from a mutual insurance company and cannot be transferred separately from that contract. Generally, the membership interests have no determinable value apart from the insurance contract itself. Further, if the insurance contract is surrendered by the policyholder or, in the event an insurance contract is terminated by payment of benefits to the contract beneficiary, these membership interests cease to exist, having no continuing value. The membership rights associated with the tax qualified retirement contracts, are acquired as a direct result of tax-favored payments to a mutual insurance company. Indeed, these membership interests cannot be obtained by any purchase separate from an insurance contract issued by Company D. In view of the foregoing, such interests are part of the tax qualified retirement contracts, created pursuant to sections 401(a), and 403(b) of the Code respectively.

Similarly, under sections 402(a), and 403(b)(1) of the Code, only amounts paid or distributed under the applicable plans, will be included in the gross income of the distributee under the rules of section 72. Section 72(e), dealing with the tax treatment of amounts not received as an annuity, provides for the inclusion of such amounts when received by the distributee.

Distributions from plans qualified under section 401(a) must be made pursuant to section 401(a)(9). Section 403(b)(11) requires distributions, under the plans, in compliance with rules similar to the minimum distribution requirements included in section 401(a)(9) and applicable to qualified plans under section 401(a) of the Code. Section 401(a)(9) and applicable regulations issued thereunder, contain the criteria for determining the minimum distribution amount for any year for which such minimum distribution is required. The minimum distribution amount is based in part on the total value of the retirement benefit. Section 401(k)(2)(B) sets states, in part that distributions may not be made earlier than (i) severance form employment, death, or disability; (ii) upon termination of the plan; (iii) in the case of a profit-sharing or stock bonus plan to which section 402(e)(3) applies, upon hardship of the employee: (iv) and will not be distributable merely by reason of the completion of a stated period of participation or the lapse of a fixed number of years.

In this case, as described above, membership interests reside outside of, and are not part of the Tax-Qualified Retirement Contracts, and the proposed liquidation distribution would be made pursuant to the liquidation of Company A. Thus, the proposed liquidation distribution would not be a distribution from or under the insurance contracts.

Accordingly, we conclude with respect to your second ruling request that cash payments made to Participants pursuant to the Liquidation will not be treated as distributions from the Tax-Qualified Retirement Contracts that are subject to section 401(k)(2)(B) or section 403(b)(11) in violation of the requirements of such sections.

This ruling is directed only to the taxpayer who requested it and applies only to Plan X as proposed to be amended as of the date of this ruling. Section 6110(j)(3) of the Code provides that this ruling may not be used or cited as precedent.

If you have any questions concerning these rulings, please contact (ID **-*****) at (***) ***-****. Please refer to T:EP:RA:T3.

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

Frances V. Sloan, Manager
Employee Plans, Technical Group 3
Tax Exempt and Government Entities Division

Enclosures:
Deleted copy of letter
Notice of Intention to Disclose
Copy of Letter to Authorized Representative

CC: